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BUILDING VALUE

BIRCH MOUNTAIN RESOURCES LTD.

ANNUAL FINANCIAL REPORT

December 31, 2005

BIRCH MOUNTAIN RESOURCES LTD.
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PRESIDENT'S REPORT TO STAKEHOLDERS

Our focus continues to be developing and maximizing the value of opportunities arising from our limestone reserves at Hammerstone. We established the Industrial Minerals Division in 2002, to explore and develop the potential for sales of limestone aggregates in the Athabasca region. Since 2002 and continuing into 2006, we have expanded the range of aggregate products and added products such as quicklime and cement, to achieve the maximum value for our limestone reserves. This past year has been a defining period for Birch Mountain and our stakeholders. We received environmental approvals for our aggregate quarry, carried out major site construction, partnered with an experienced local aggregate operator, and formalized Hammerstone Products Ltd., our sales and marketing partnership with the Fort McKay First Nation. Each step was a critical milestone to opening our quarry in December 2005. Corporately, our strategy of moving our U.S. trading to the American Stock Exchange positioned Birch shares in a larger, more liquid market and was followed by a successful financing of $36,000,000 to fund our quarry construction and operations.

OUTLOOK

Oil prices held at high levels in 2005, averaging approximately US $56 for West Texas Intermediate (WTI). Forecasters such as the Canadian Energy Research Institute (CERI) and the U.S. Energy Information Administration have moved their long-term oil price forecasts from the mid US $20s to the high US $50s, reducing the risk that oil sands projects that have been announced or are in construction will not proceed, or those in production will be shut in prior to reserves exhaustion. According to recent work commissioned by Birch, CERI forecasts oil sands bitumen supply to achieve as much as 11 million barrels per day by 2070. This creates value for Birch because increased production from the oil sands generates increased demand for our limestone products and ensures the long-term stability of this demand. Prevailing consensus in energy circles is that scheduled development of the oil sands will proceed as long as oil prices remain above US $35.

We are enviably positioned for substantial growth via three waves of value creation:

1. Acceleration of oil sands industry growth powered by high oil prices,
2. An expanded suite of limestone products,
3. Increased demand for desulphurization reagent products such as lime and limestone as oil sands producers switch from natural gas to alternative fuels such as bitumen and coke.

The staff, management team and Board of Birch Mountain wish to thank our shareholders and other stakeholders for their support over the past several years. We are confident that our strategies are sound and will lead us to achieve new milestones in 2006.

On behalf of the Board of Directors,

"signed"

Douglas Rowe, President & CEO

SELECTED ANNUAL FINANCIAL INFORMATION

Selected Annual Financial Information	2005	2004	2003
Limestone sale	$ -	$ -	$ 100,000
Interest and other income	332,568	48,190	211,973
G&A expenses	4,433,905	2,172,876	1,136,023
Mineral exploration costs	540,481	762,371	744,385
Loss	4,641,818	2,887,057	1,568,435
Loss per share, basic and fully diluted	$ (0.08)	$ (0.05)	$ (0.04)
Total assets	$ 48,560,852	$ 9,532,423	$ 2,424,233
Capitalized mineral exploration costs	13,768,974	3,489,369	336,136

Birch Mountain has virtually no revenues and our funding has come primarily from equity financings. The Company has incurred operating losses since inception in 1995, and, as of December 31, 2005, has an accumulated deficit of $7,290,627. Losses are primarily from costs associated with the development of the Industrial Minerals Division, including the opening of the Muskeg Valley Quarry ("MVQ") and the development of the Hammerstone Project. Prior to 2003, losses were from activities in mineral exploration and scientific research. Results of operations have fluctuated from period to period and may continue to do so in the future, depending on the timing, amount and type of funding. Additional operating losses are expected in the future as a result of the continued development of the quarry and Hammerstone and investment in exploration and technology. However, the Industrial Minerals Division is expected to start generating revenue from aggregate sales in the first six months of 2006.

Revenue is primarily from interest income on short-term investments and in 2003 Birch Mountain reported a limestone sale. More significant interest income was reported in 2005 from the investment on funds raised in the Company's September 2005 financing. In 2004, interest income was from invested monies received from small private placements throughout the year. In 2003, the majority of the income was from forgiveness of a 1998 accrued debt resulting in a gain of $194,000.

G&A expenses have risen in 2005 as the Company moves forward with activities necessary for operations, including work necessary for the filing of the Hammerstone Environmental Impact Assessment and Application (the "Hammerstone Application") and the payment of professional fees related to the independent technical report. G&A expenses increased $2,261,029 or 104%, of which $1,160,487 or 51% was related to stock-based expenses. The remaining increase of $1,100,542 is related to development, operations and corporate activities.

Expenditures on the Company's mineral properties in 2005 increased to $11,560,087 (including capitalization of $10,279,606 of mineral exploration costs) compared with $3,915,604 (including capitalization of $3,153,233 of mineral exploration costs) in 2004 and $1,080,521 (including capitalization of $336,136 of mineral exploration costs) in 2003. In 2003, the Company began capitalizing costs associated with development, as management believes the costs will be recovered from future operations, which is supported by the independent technical report prepared by AMEC Americas Ltd.

As a result of increased activity and expenditures, the loss in 2005 increased to $4,641,818 versus $2,887,057 in 2004 and $1,568,435 in 2003. In 2005, the Company capitalized $10,279,606 (2004 - $3,153,223; 2003 - $336,136) of mineral exploration costs. Our primary source of cash has been private placement financings and cash from the exercise of stock options and warrants. In 2005, Birch Mountain received more than $40.4 million (2004 - $9.4 million, 2003 -$4.6 million), ending the year with working capital of $27.4 million and total assets of $48.6 million compared with working capital of $2.8 million in 2004 and $1.0 million in 2003.

MANAGEMENT'S DISCUSSION & ANALYSIS

INTRODUCTION

The following discussion and analysis (MD&A) is current as of **March 15, 2006**, and is management's assessment of the operations and financial results together with future prospects for Birch Mountain Resources Ltd. ("Birch Mountain" or the "Company"), and should be read in conjunction with the audited Consolidated Financial Statements of the Company as at and for the years ended **December 31, 2005** and December 31, 2004. The accompanying audited consolidated financial statements ("financial statements") of the Company have been prepared by the management of Birch Mountain Resources Ltd., in accordance with Canadian generally accepted accounting principles ("GAAP"). All financial information is expressed in Canadian dollars unless otherwise stated.

Birch Mountain is a resource company with activities in industrial minerals and precious metals. The Company has defined a limestone mineral reserve on its mineral leases in northeastern Alberta. The size and value of the reserve is based on independent technical reports by AMEC Americas Limited ("AMEC"), prepared in compliance with Canadian Securities Advisors' National Instrument 43-101, Standards of Disclosure for Mineral Projects, and available at www.sedar.com and www.sec.gov. The Company is in the development stage and is dependant on obtaining sufficient capital to carry out development activities, including moving into profitable production of the reserve.

The MD&A is based on certain assumptions and analyses made by the Company in light of its experience and its perception of historical trends, current conditions and expected future developments as well as other factors it believes are appropriate in the circumstances. However, whether actual results, performance or achievements will conform with the Corporation's expectations and predictions is subject to a number of known and unknown risks and uncertainties which could cause actual results to differ materially from the Corporation's expectations, including but not limited to: fluctuations in the price and demand of oil and gas; fluctuations in the level of oil and gas exploration and development activities; fluctuations in the demand for the Company's products; the existence of competitors, technological changes and developments in the oil and gas industry; the ability of oil and gas companies to raise capital; the effects of severe weather conditions on operations and facilities; the existence of operating risks inherent in mining and exploration; political circumstances impeding the progress of the Company or its customers; general economic, market or business conditions, including stock market volatility; changes in laws or regulations, including taxation, and environmental; the lack of available qualified personnel; and other unforeseen conditions.

Consequently, all of the forward-looking statements made in this report are qualified by these cautionary statements and there can be no assurance that the actual results or developments anticipated by the Company will be realized or, even if substantially realized, that they will have the expected consequences to or effects on the Company or its business or operations. The Company assumes no obligation to update publicly any such forward-looking statements, whether as a result of new information, future events or otherwise.

OVERVIEW

Birch Mountain is developing the industrial mineral reserves of its extensive mineral properties in the oil sands region of northeastern Alberta. The Company's Muskeg Valley Quarry (the "MVQ") and planned Hammerstone Projects will produce construction aggregates, used in road building, and rock for making concrete and asphalt. Reagent grade limestone can be used directly or in processed form as quicklime in applications such as flue gas desulphurization, water treatment, pulp and paper manufacturing and soil and biosolids stabilization.

The Company is in the final stages of opening a limestone quarry for aggregate sales and is in the planning stages for the operation of a plant for the manufacturing of quicklime and other products. The quarry and plant will be located on mineral leases where the limestone is exposed at surface or beneath a thin covering of overburden, allowing for open pit extraction. The Company has received regulatory approval and the necessary environmental operating permits to commence aggregate operations and sales from the MVQ. Site preparation work began in August 2005 and the quarry was officially opened in December 2005, allowing for the start of commercial production. The expansion of the quarry and construction of a quicklime plant, Birch Mountain's Hammerstone Project, continues to be the strategic focus of the Company and on-going work continues to advance the development of the project. As a result of this large opportunity, significant investment in precious metal exploration and technology development has been deferred.

Neither Birch Mountain nor our predecessor company has ever declared or paid dividends on our common shares.

Preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, to disclose contingent assets and liabilities at the date of the financial statements and to report amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates relate to the deferral and valuation of exploration expenditures. Actual results could differ from the estimates.

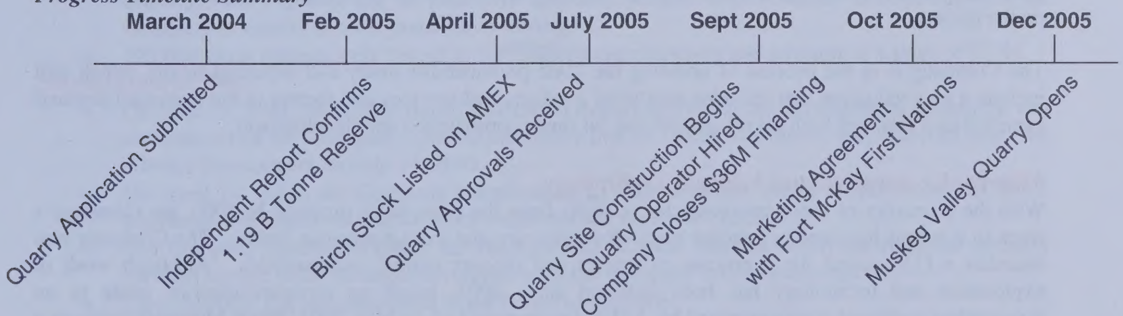
PERFORMANCE

Industrial Minerals Division

The considerable geological, engineering and economic work, performed by the Company, and independently confirmed, shows significant opportunity for limestone production on the Company's mineral leases. Based on independent technical reports prepared by the Canadian Energy Research Institute ("CERI") and AMEC, Birch Mountain is satisfied that the long-term demand for limestone products related to oil sands construction and operations, as well as regional infrastructure development, is considerable. A shortage of gravel in the Regional Municipality of Wood Buffalo was identified by local operators and in mid 2002 the industrials minerals division was formed to assess opportunities. The shortage of gravel was confirmed in a 2003 survey on gravel and concrete supply and usage by oil sands lease holders completed by the Athabasca Regional Issues Working Group ("RIWG"), a committee of representatives from oil sands companies, local government and other major interested parties in the area. In addition, expressions of interest from the oil sands industry in a local supply of quicklime for use in flue gas desulphurization and water treatment led the Company to evaluate the production of quicklime from limestone in its proposed quarry. Accordingly, Birch Mountain's business strategy to develop the limestone opportunity into an aggregate and reagent products business was started.

Calcining tests showed that two of the four geological layers in the limestone are suitable for the production of quicklime. The Company then undertook geological, environmental and archaeological fieldwork and testing to determine the development strategy for this opportunity and assess the potential environmental impacts of development at this location. Laboratory testing confirmed the limestone was an excellent rock for use in concrete and calcining tests showed that two geological layers in the limestone are suitable for the production of quicklime. An environmental impact assessment ("EIA") and application, collectively referred to as the Application, was prepared for the Natural Resources Conservation Board ("NRCB") and Alberta Environment. Upon approval, the Company began site preparation work and officially opened the Muskeg Valley Quarry in December.

Progress Timeline Summary



Progress Timeline Details

In March 2004, the Company filed its Application for the development, operation and reclamation of the MVQ, which covers an area of approximately 255 hectares. In December 2004, the EIA was declared complete by Alberta Environment and with no interventions opposing the Application, the NRCB determined a public hearing was not required. The Company received final regulatory approval on July 14, 2005, and by the end of July had received all operating permits needed to begin construction of the MVQ.

During the first two quarters of 2005, the Company advanced the MVQ. With the necessary operating permits in place for the Muskeg Valley Quarry, Noramac Ventures was contracted as the general contractor for site preparation and access road construction.

During the last two quarters of 2005, site construction was completed to allow for the opening of the MVQ before the end of the year. Trees and overburden were cleared and a two-kilometer commercial access road was established. The Company extracted limestone from surface exposures to use its own aggregate in building an access road. During the year, $6 million was spent.

The project was delayed by approximately three weeks due to unusually wet weather in the region and an additional five weeks so that the initial area of tree clearing and overburden stripping could be expanded to improve access to high-grade limestone for early project sales. The effect of the increase in the cleared and stripped area combined with the effects of the wet weather has increased site preparation costs by an estimated $4 million, with approximately one-half of this amount advancing quarry expansion work that was originally planned for 2006-2007.

The Company contracted a local company, Stony Valley as the quarry operator. Stony Valley will blast, crush, screen and stockpile various grades of aggregate product as directed by Birch Mountain. The MVQ operations will benefit from the local expertise of the quarry operator who has the personnel and equipment for utilization in the MVQ. Commercial sales of products will be done directly and through a joint venture with the Fort McKay First Nation, named Hammerstone Products Ltd., which will be the marketing arm of Birch Mountain.

With respect to the quicklime opportunity, during 2005 the Company conducted further sampling, engineering and environmental studies to gather data for the Hammerstone Project EIA and Application. A number of opportunities in addition to quicklime production, such as cement production, are being considered for inclusion in the Application. This application will be filed in 2006 after the completion of strategic assessments of each opportunity and their environmental and socio-economic impacts. The Hammerstone Project is contiguous with the MVQ and expands the area of the quarry to approximately 1,500 hectares. Additional testing on the Company's limestone in early 2005 by independent parties produced test results that confirm the high quality of the limestone in the Company's quarry. These results support the Company's strategy to provide quicklime to the oil sands industry and the Company has retained Phoenix Processing Engineering Inc., an independent lime process engineering company to consult on the project.

The Company is in the process of updating the 2005 prefeasibility study and technical report, which will include a new valuation that includes additional products and services and factors in the increased demand expected as a result of high oil prices spurring oil sands construction and development.

Mineral Exploration and Mineral Technology

With the discovery of metal nanoparticles in rocks from the Company's property in 2000, the Company's work in this area has been to develop methods to measure and extract precious metals. The Company was awarded a U.S. patent for a process to extract and recover natural nanoparticles. Although work in exploration and technology has been deferred since 2003, based on recommendations made in an independent technical report prepared by APEX Geoscience Ltd. in May 2003, Birch Mountain believes a significant opportunity exists in precious metals and intends to continue research and develop the precious metals potential of the Athabasca property. The Company has no assurance there are commercial concentrations of precious metals on its mineral properties, or that a commercially viable process for precious metal extraction will be developed.

Since 2003, the Company has spent minimal amounts in this division in order to hold patents and allow for some small level of future research work, directed at evaluation of opportunities that may exist in the limestone or on other permit lands the Company holds in northern Alberta.

SUMMARY OF QUARTERLY RESULTS

Quarterly Results	2005				2004			
Three months ended	**Dec 31**	**Sept 30**	**June 30**	**Mar 31**	**Dec 31**	**Sept 30**	**Jun 30**	**Mar 31**
Interest and other income	$ 209,366	$ 73,612	$ 23,802	$ 25,788	$ 24,799	$ 14,102	$ 1,540	$ 7,749
G&A expenses	1,102,460	1,152,192	957,554	1,221,699	914,959	472,059	418,824	367,034
Mineral exploration costs	72,482	83,450	163,857	220,692	282,515	124,107	185,427	170,322
Loss for the period	(965,576)	(1,162,030)	(1,097,609)	(1,416,603)	(1,172,675)	(582,064)	(602,711)	(529,607)
Loss per share - basic and fully diluted	(0.03)	(0.01)	(0.02)	(0.02)	(0.02)	(0.01)	(0.01)	(0.01)
Total assets	$48,560,852	$45,233,378	$10,129,992	$9,436,026	$9,532,423	$7,417,076	$2,194,603	$2,765,642
Mineral properties	$13,768,974	$7,749,149	$5,306,228	$4,235,705	$3,489,369	$2,598,045	$1,502,987	$1,151,322

Major Events in 2005

Fourth Quarter 2005

- The Muskeg Valley quarry is opened, after the majority of site construction is complete.
- Birch Mountain stock begins options trading on the Chicago Board of Options Exchange and the Pacific Exchange and the Company is named to the TSXV 50, a list of the 50 top performing stocks on the Toronto Venture Exchange for 2005.
- The Company established a joint venture with the Fort McKay First Nation for the sales and marketing of aggregate products. The marketing company is named Hammerstone Products Ltd.

Third Quarter 2005

- Stony Valley was hired as the quarry operator and will be responsible for the blasting, crushing, screening and stockpiling of aggregate products at the Muskeg Valley Quarry.
- On September 2, 2005, the Company completed a public offering of 9 million common shares at a price of $4.00 per share. The $36 million gross proceeds will fund initial operations of the Muskeg Valley Quarry and strategic development of the limestone reserve.
- On July 14, 2005, the Alberta Cabinet issued its Order in Council approving operations of the Muskeg Valley Quarry and all necessary operating permits were obtained in July, allowing the Company to commence site preparation in August.
- 225,000 stock options were issued in November to an employee and advisors at a price of $7.81.

Second Quarter 2005

- On June 15, 2005, the NRCB issued a Decision Report approving the development, operations and reclamation of the Company's limestone quarry and an Order in Council was received from the Alberta Government on July 14, 2005.
- On April 14, 2005, the Company's application to trade common shares on the American Stock Exchange was approved and the stock began trading on April 21, 2005.
- The Company announced that it had engaged RBC Capital Markets to provide financial advisory services related to the strategic development of the Company's limestone reserves.
- Larry Shelley, CA was appointed to the Board of Directors.
- The Company changed its independent auditor to Ernst and Young LLP.
- On May 17, 2005, the Company held its annual general and special meeting and a new shareholder rights plan was approved to replace an existing plan that was expiring.
- 350,000 stock options at with an exercise price of $2.09 per share were issued during the quarter to a newly appointed director to replace options at exercise prices ranging from $2.35 to $2.48 per share, previously issued to the individual in their role as an advisor.

First Quarter 2005

- AMEC completed a prefeasability report that detailed the limestone reserve over the quarry life, from which a technical report in accordance with National Instrument 43-101 was completed and made available to the public. The full report can be found on www.sedar.com under the Birch Mountain filings – Technical Report filed March 24, 2005.
- 1,890,000 stock options were issued during the quarter to employees and directors at prices ranging from $2.35 to $2.48.

RESULTS OF OPERATIONS

The Company incurred a loss of $4,641,818 in the year ended December 31, 2005 (2004–$2,887,057; 2003–$1,568,435) and as at December 31, 2005, had retained deficit of $7,290,627.

Corporate Income

The Company earned interest income in 2005 of $323,568 and 2004 of $48,190. In 2003, income included a small amount of interest, revenue from an agreed sale of $100,000 of limestone to Syncrude Canada Ltd. and a gain on forgiveness of debt for $194,000. Birch Mountain has not had regular ongoing revenue from customers as the Industrial Minerals Division was under development. The Company's ability to generate income requires sales from the MVQ and this is the Company's focus in 2006.

General and Administrative Expenses

In 2005, adjusted G&A expenses totaled $2,445,105.

General and Administrative Expenses	2005	2004	2003
Total Expenses	**$ 4,974,386**	$ 2,935,247	$ 1,880,408
Less Mineral Exploration Costs	**540,481**	762,371	744,385
G&A Expenses	**4,433,905**	2,172,876	1,136,023
Less Stock Based Expenses	**1,442,536**	282,049	66,681
Less Accrued Other Liabilities included in office expenses	**546,264**	300,000	-
Adjusted G&A Expenses	**$ 2,445,105**	$ 1,590,827	$ 1,069,342

Total G&A expenses have risen in 2005 as the Company moves forward with activities necessary for operation, including work necessary for the preparation of the Hammerstone Application and the payment of professional fees for the independent technical report released in March 2005. G&A expenses increased $2,261,029, or 104%, of which 51% of the increase or $1,160,487 was related to stock-based expenses, and 11% of the increase for a $246,264 accrual of estimated interest, penalties and corporate taxes payable upon re-filing its flow through share renouncements. The remaining adjusted increase in 2005 of $854,278 or 53% over the prior year reflects additional corporate activity for the development of the Company's limestone reserve in its Athabasca leases. Specifically these include:

- An increase of approximately $211,000 in salaries resulting from the hiring of two senior employees;
- An increase of approximately $150,000 in professional fees, after adjustment for the inclusion of stock-based expenses in the amount of $197,115 for options issued to a Board advisor, which have already been deducted from adjusted G&A expenses. The majority of the increase in professional fees, approximately $90,000, is due to an increase in business activity, including quarterly reviews by independent accountants and regular legal fees for corporate activity. In addition, professional fees of $60,000 were paid for various special projects such as a tax review and accounting policy development.
- An increase of approximately $412,000 in shareholder services and promotion as a result of an expanding investors base resulting from the American Stock Exchange (AMEX) listing in April 2005 and increased promotion as the Company moves into operations. Of the increase, approximately $57,000 is related to the AMEX listing, $132,000 related to additional travel for investor meetings, $53,000 related to increase publication and distribution of Company materials to an increased number of shareholders, $130,000 related to increased filing and reporting fees in Canada and the United States, and $32,000 from increased advertising.

Mineral Exploration Costs

In 2005, the Company spent a total of $10,820,087 of which $10,279,606 was capitalized.

Mineral Exploration Costs	2005	2004	2003
Industrial Minerals Costs	$ 10,279,606	$ 3,153,233	$ 807,327
Mineral Exploration and Technology Costs	540,481	762,371	273,194
Total Mineral Expenditures	10,820,087	3,915,604	1,080,521
Less Amounts Capitalized	10,279,606	3,153,233	336,136
Mineral Exploration Expenses	$ 540,481	$ 762,371	$ 744,385

Industrial Minerals Costs

In 2005, we focused most of our resources on the opening to the MVQ. In 2005, $10,279,606 was spent with this entire amount being capitalized, in 2004, $3,153,233 was spent with this entire amount being capitalized and in 2003, $807,327 was spent with $336,136 of this amount being capitalized. In 2005 these industrial mineral costs can be broken down into four broad categories with the following estimated expenditures:

- Site construction of $5.9 million paid to Noramac Ventures for the excavation and stockpiling of surface overburden, opening of the quarry pit and construction of a road and scale foundations;
- Payments of $2.6 million to contractors and consultants for engineering, drilling, technical, environmental and regulatory services including any related materials;
- An accrual of $360,000 for future site reclamation costs to for the Muskeg Valley Quarry; and
- Various administrative costs and salaries directly related to the Muskeg Valley Quarry or the Hammerstone Project.

Mineral Exploration and Technology Costs

Mineral exploration costs in 2005 were $540,481 as compared to $762,371 in 2004 and $273,194 in 2003. The Company continues a small amount of funding to this division in order to hold patents and allow for some small level of future research work, directed at evaluation of opportunities that may exist in the limestone or on other permit lands the Company holds in northern Alberta outside of the MVQ or Hammerstone Project footprint.

LIQUIDITY AND CAPITAL RESOURCES

Birch Mountain is in the development stage. The Company has virtually no revenues and funding has come primarily from private and public financings. The Company has incurred operating losses since its inception in 1995, and as of December 31, 2005, has an accumulated deficit of $7,290,627, after an adjustment, approved by shareholders in June 2004, for the elimination of $27,748,932 of deficit. Losses are from costs incurred in the development of the Industrial Minerals Division, exploration of mineral opportunities and research of mineral technology. Results of operations have fluctuated from period to period and may continue to do so in the future. Additional operating losses may occur in the future as a result of the continued development of the MVQ and the Hammerstone Project. However, the Muskeg Valley Quarry is expected to start generating income from aggregate sales in 2006.

Working capital at December 31, 2005 is $27,474,950, an increase of approximately $24.7 million from December 31, 2004. The increase resulted primarily from the Company's $36 million equity financing during the third quarter of 2005.

During the year, Birch Mountain received $4.3 million from the exercise of stock options and warrants and completed a financing for net proceeds, after costs of financing, of $33.7 million. At gross expenditure rates consistent with 2005, the Company has existing capital to continue operations into the foreseeable future. However, as the Company develops its limestone reserve and builds plant facilities additional funds may be required. The current estimates for capital for the initial phases of the MVQ and the Hammerstone Project are $130 million. The Company is investigating strategic options of early investment in plant process equipment, which may require immediate capital. After initial operations of the MVQ, project-specific financing may be available for the longer-term development of the Hammerstone Project.

COMMITMENTS

On-going commitments for capital resources relate largely to the maintenance of the mineral permits and leases granted to the Company by the Government of Alberta plus some general operating leases. At December 31, 2005, the Company holds mineral leases, mineral permits and mineral permits for which applications have been filed for conversion to leases, in the Athabasca region, covering an area of 402,748 hectares (995,208 acres). Lease payments, along with associated fees in 2006 and years beyond will be approximately $460,000 annually, if Birch Mountain continues to hold all of its mineral leases into the future. Mineral permits are maintained in good standing by making allowable exploration expenditures, although there is no obligation to do so. Birch Mountain continuously evaluates its mineral permit holdings, relinquishing and/or acquiring permits as dictated by financial considerations as well as exploration and strategic priorities.

The Company is required to reclaim any land disturbances as outlined in its environmental approvals for the MVQ. The Company estimated, based on costs provided by consulting engineers of the Company, the costs for third parties to return the MVQ to its reclaimed status as at December 31, 2005, would be $1,100,000. For financial statement purposes, these costs have been discounted to $360,000. Based on a preliminary estimate, the Company issued a letter of credit to Alberta Environment for $670,000 for this reclamation work. The Company must re-evaluate this annually and post additional security with Alberta Environment. Also in connection with land disturbances, the Company was required to pay timber damage fees for immature trees removed, which have not reached commercial value. The Company paid fees based on the permitted area of the MVQ even though not all the trees were cut during 2005. A long-term asset has been recorded for the balance of amounts prepaid and this will be reduced as trees are actually cleared.

The Company estimated a future liability for the indemnification of shareholders for flow-through shares issued in 2003 and 2004, for which the Company was not able to incur qualifying expenditures. The estimated liability and potential taxes payable, interest and penalties payable in the amount of $3.3 million has been accrued as an other current liability. Subsequent to year-end, the Company amended its tax filing position and has reported the impact to the subscribers. The actual liability will not be known until the Canada Revenue Agency reassesses each affected subscriber and the amounts are known by the Company. The payment of the liability may stretch over many future years and could vary by up to fifteen percent.

RISKS AND UNCERTAINTIES

Birch is Currently in the Development Stage

Birch is currently in the development stage. There is a risk that operations may have delays, interruptions or increased costs or that operations may not commence at all, due to many factors, including, without limitation:

- breakdown or failure of equipment or processes;
- production performance falling below expected levels of output or efficiency;
- design errors;
- contractor or operator errors;
- non-performance by third-party contractors;
- labour disputes, disruptions or declines in productivity;
- increases in materials or labour costs;
- inability to attract sufficient numbers of qualified workers;
- delays in obtaining, or conditions imposed by, regulatory approvals;
- changes in the scope of the development or operations;
- markets for products don't develop as expected;
- violation of permit requirements;
- disruption of energy supply; and
- catastrophic events such as fires, earthquakes, storms or explosions.

The current construction and operations schedules may not proceed as planned, there may be delays and the development of the MVQ and the Hammerstone Project may not be completed on budget. Any such delays will likely increase the costs and may require additional financing, which financing may not be available. Actual costs to construct and develop the MVQ and the Hammerstone Project will vary from estimates and such variances may be significant.

Given the stage of development of the MVQ and the Hammerstone Project, various changes may be made prior to completing construction. Based on current scheduling, the Hammerstone Project is not expected to start commercial quicklime operations until 2009. The information contained herein, including, without limitation, reserve and economic evaluations, is conditional upon receipt of all regulatory approvals and no material changes being made to the MVQ and the Hammerstone Project.

Capital

Birch Mountain currently has insufficient revenue to meet its yearly operating and capital requirements. The Company has successfully raised funds necessary to explore its leases and permits, to prepare for and plan operations and to conduct its corporate affairs primarily through private placements of common stock. There is no guarantee the Company will be able to continue to raise funds or to successfully partner with a company that has the necessary capital. In the past, Birch Mountain has financed the business by raising funds in the equity markets. As required in the future or as advantageous to the Company, financing may be available through joint venture or partnering agreements, through additional private placements or by obtaining project debt financing. Although these are alternatives the Company will investigate, there is no assurance that the Company will be successful in raising the capital it needs to continue its business.

Regulatory and Environmental Requirements May Impact the Corporation's Ability to Operate

The Company operates in areas that are subject to governmental provisions regulating exploration and development of mineral resources. Birch Mountain may be constrained or forbidden to develop a quarry or mine in areas of economic mineral deposits or mandated operating guidelines may adversely affect the economic viability of the projects. Additionally, the Company holds metallic and industrial mineral permits and leases issued by the Government of Alberta and there are no guarantees the Government will continue to extend land rights under its current practices.

Birch Mountain is required by regulation to operate under certain environmental guidelines that are mandated by the Government of Alberta and the Government of Canada. Additionally, public expectation of industry's environmental performance remains high and interventions by environmental groups could impact the Company's ability to operate. Birch Mountain has established environmental policies that it believes will allow it to operate effectively under the environmental guidelines. Birch Mountain has and will continue to work with the regulators and local communities to address public environmental concerns.

Competitive Risk May Reduce the Corporation's Ability to Operate
Birch must develop the mineral deposits and there is no assurance the type or amount of the deposit will produce the economic results expected. Additionally, Birch must negotiate sales arrangements with its customers and prove that its products are reliable and suitable for use in the oil sands industry. Although Birch believes that competing aggregates resources in the Fort McMurray region are limited in both size and quality and, as a result, high market share assumptions have been made, Birch may have to compete with larger companies that have greater assets and financial and human resources than Birch, and which may be able to sustain larger losses than Birch to develop business. Birch and the economic viability of the MVQ and the Hammerstone Project may be negatively impacted if a new source of aggregates and/or industrial minerals is located and developed.

Independent Reviews Provide No Assurance of Future Results
Although third parties have prepared reviews, reports and projections relating to the viability and expected performance of the MVQ and the Hammerstone Project, it cannot be assured that these reports, reviews and projections and the assumptions on which they are based will, over time, prove to be accurate. The ability of Birch Mountain to obtain necessary approvals, to extract a quality product and to secure adequate operating and capital financing, to successfully put the quarry and plant into production and to operate profitably in the future are uncertain.

Customer Dependency May Reduce the Flexibility of the Company to Operate
For the sale of aggregate and less so for the sale of reagent products, Birch Mountain is dependant on customers located geographically near the limestone quarry and production facilities. Costs of transportation of aggregate are high relative to its cost of production and tend to be prohibitive to customers who might ship the product over longer distances. As a result, Birch Mountain plans to market products to the oil sands industry in the Fort McMurray region. With market concentration based on geography, Birch Mountain is dependant on production and expansion in the local area. Should the price of oil decline, there is no guarantee oil sands companies will continue to require the Company's products in sufficient quantities to ensure profitable operations.

Personnel Risks May Impact the Company's Ability to Carry Out its Operational Plans
The Company employs fifteen employees and relies on part time workers, contractors and consultants to assist in executing operations and providing technical guidance and must rely on workers in the local area. In Northern Alberta, skilled labour shortages are common. There is uncertainty surrounding the ability to retain and attract personnel to the project and, should the Company not have adequate personnel, the project may not become operational or may not be economically viable.

Alternate Technologies May Reduce the Demand for the Company's Products
The use of limestone for aggregates and the use of quicklime as a product for desulphurization of air emissions and water treatment could be replaced by alternate technologies as the oil sands industry looks at more cost effective and efficient methods. The rate of development of new technologies or the impact on the Company's business cannot be determined.

OFF-BALANCE SHEET ARRANGEMENTS

The Company has an operating line with a Canadian chartered bank that provides for an operating overdraft on the Company's chequing account and is available for letters of credit. At December 31, 2005, the Company has issued letters of credit under this agreement, in the amount of $670,000, to Alberta Environment for future site reclamation liabilities. As security for this operating line, the Company has pledged $1,000,000 of short-term investments on deposit at the bank. These particulars are disclosed in the Company's financial statements.

DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Company is accumulated and communicated to the Company's management as appropriate to allow timely decisions regarding required disclosure. The Company's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by the annual filings, that the Company's disclosure controls and procedures as of the end of such period are effective to provide reasonable assurance that material information related to the Company, including its consolidated subsidiaries, is made known to them by others within those entities. It should be noted that while the Company's Chief Executive Officer and Chief Financial Officer believe that the Company's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met

FINANCIAL INSTRUMENTS

The carrying amount of cash and cash equivalents, restricted cash, accounts receivable, accounts payable and other current liabilities approximates their fair value because of the short-term maturities of these items. Occasionally, the Company enters into transactions to purchase goods and services denominated in United States currency for which the related expenses and accounts payable balances are subject to exchange rate fluctuations. The transactions and balances have been stated in Canadian dollars in accordance with the Company's foreign currency translation policy.

RELATED-PARTY TRANSACTIONS

The Company had the following transactions with related parties during the year:

- Included in shareholder services and promotion are amounts of $7,874 (2004–$14,656) paid to a company controlled by the spouse of a director;
- Included in professional fees is $85,734 (2004–$37,159) of consulting and legal fees paid to a company owned by an officer;
- Included in professional fees is $240,859 (2004–$99,145) of legal fees paid to a firm in which an officer is a partner; and
- Included in accounts payable is $18,789 (2004–$7,945) relating to these transactions.

These transactions were in the normal course of operations and were measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the consolidated financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets liabilities, expenses and contingent liabilities. The Company evaluates the estimates periodically. In making judgments about the carrying values, the Company uses estimates based on historical experience and various assumptions that are considered reasonable in the circumstances. Actual results may differ from those reported. The Company reviews significant areas subject to estimation with the Audit Committee. Significant areas requiring estimates include the determination of capitalization and impairment of mineral properties and capital assets and reclamation obligations, other current liabilities and the calculation of stock-based compensation expenses.

Mineral properties

As the majority of the Company's activities relate to the acquisition of mining leases and permits and the exploration and development thereon, all expenditures relative thereto, including general and administrative expenses, have been capitalized on the basis of each area of potential. These capitalized expenditures will be charges against income, through unit of production depletion, when properties commence commercial production. The related costs of abandoned areas are charged against income. If a mineral property becomes impaired it will be written down to the impaired value in the period the impairment is determined. The amounts recorded for mineral properties represent costs to date and do not necessarily reflect present or future value. Recovery of capitalized costs is dependent upon successful development of economic operations or sale of such property in amounts at least equal to costs capitalized.

Costs estimated for future site reclamation are based on estimates of independent consultants and are discounted based on an interest rate and expected timing of the future expenditures. These assumptions could change in the future and could impact the recorded obligation. Actual future costs could vary materially from those recorded.

Other current liabilities

The Company raised capital through the issuance of flow through shares in 2003 and 2004, that provided for an indemnity to the subscriber for additional taxes payable if Birch was unable to or failed to renounce the qualifying expenditures as agreed, without limiting the recourse of the subscriber. The Company applied for and filed the necessary forms to qualify for and renounce expenditures in 2002, 2003 and 2004 and has subsequently determined some of these expenditures do not qualify for flow through tax treatment. The Company is exposed to costs for the indemnification of the subscribers and any assessed corporate taxes, penalties and interest. The Company has estimated and accrued a potential liability in the amount of approximately $3,346,264. This amount is based on assumptions of the tax filing positions of the subscribers, their tax rates and an estimate of corporate taxes, penalties or interest that may be payable, which will not be known until any potentially affected subscribers as reassessed for their tax positions by the Canada Revenue Agency and these amounts become known to the Company. The Company believes this estimate could vary higher or lower by up to fifteen percent.

Stock-based compensation

The Company has stock-based expenses for stock option awards to employee, directors, officers and advisors, as explained in the accompanying financial statements. Effective January 1, 2003, the Company adopted the recommendations of the Canadian Institute of Chartered Accountants for recording stock-based compensation and payments. These standards require that all stock-based awards to employees and non-employees be accounted for in the Company's financial statements using the fair value method. Under this method, the fair value computation requires estimates of the expected life of the option, stock volatility and the risk-free interest rate expected over the life of the option. A change in these assumptions could materially change the amount of stock-based expenses recorded.

CHANGES IN ACCOUNTING POLICIES INCLUDING INITIAL ADOPTION

There were no changes in accounting policies during the year ended December 31, 2005. In 2006, the Company may be impacted by changing or new accounting policies that relate to areas of its business.

Stripping Costs

The Emerging Issues Committee ("EIC") of the Canadian Institute of Chartered Accountants ("CICA") issued *EIC160 Accounting for Stripping Costs in the Mining Industry.* The standard outlines accounting for overburden and mine waste materials removed in the process of accessing mineral deposits. Generally stripping costs should be accounted for as variable production costs that should be included in the costs of inventory produced in the period the stripping costs were incurred. If it can be shown that the stripping was for betterment of the mineral property, stripping costs should be capitalized. The standard outlines the requirement for amortization of capitalized stripping costs as well as a reconciliation of stripping costs incurred in the production phase. Pre-production stripping costs are not included. This EIC is to be applied to stripping costs incurred in fiscal years beginning on or after July 1, 2006 and may be applied retroactively. The Company will adopt this standard for its fiscal year ended December 31, 2006.

Comprehensive Income

The CICA issued a new Section 1530 on April 1, 2005 outlining the requirement to report comprehensive income. An enterprise should present comprehensive income and its components in a financial statement with the same prominence as other financial statements that constitute a complete set of financial statements Comprehensive income is the change in equity (net assets) of an enterprise during a period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. This Section applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. The Company expects to initially adopt this standard for the quarter ended March 31, 2007.

ADDITIONAL DISCLOSURE FOR VENTURE ISSUERS WITHOUT SIGNIFICANT REVENUE

Additional Disclosure for Venture Issuers without Significant Revenue	2005	2004	2003
Total Assets	**$ 48,560,852**	$ 9,532,423	$ 2,424,233
Total Expenses during the year	**$ 4,974,386**	$ 2,935,247	$ 1,880,408
Mineral exploration			
Capitalized mineral expenditures	$10,279,606	$ 3,153,233	$ 336,136
Expensed mineral costs	540,481	762,371	755,535
Administrative and corporate expenses	4,433,905	2,172,876	1,124,873

Mineral Costs	2005 Capitalized	2005 Expensed	2004 Capitalized	2004 Expensed	2003 Capitalized	2003 Expensed
Asset retirement obligation	$ 335,000	$ -	$ 25,000	$ -	$ -	$ -
Administration	731,754	36,209	73,910	34,276	5,473	65,797
Assay and geological	28,004	84	77,740	654	–	20,429
Land lease and permit	9,278	390,088	47,320	611,857	3,210	146,327
Materials, services and drilling	2,563,638	18,130	2,308,342	45,737	212,325	179,060
Infrastructure	5,941,256	-	60,571	-	-	-
Salaries	478,755	89,715	479,089	66,708	105,166	315,925
Travel and accommodations	191,921	6,255	81,262	3,319	9,962	16,847
	$ 10,279,606	**$ 540,481**	$ 3,153,233	$ 762,371	$ 336,136	$ 744,385

Corporate Expenses	2005	2004	2003
Amortization	$ 63,424	$ 50,336	$ 33,632
Consulting	96,027	79,973	800
Office	942,502	683,316	263,247
Professional fees	746,377	396,552	125,175
Salaries and benefits	597,714	386,579	422,135
Shareholders services and promotion	742,439	329,993	213,203
Stock based compensation	1,245,422	246,127	66,681
	$ 4,433,905	$ 2,172,876	$ 1,124,873

Outstanding Share Data at March 15, 2006	Number
Issued and outstanding common shares	80,887,237
Outstanding options to purchase common shares	7,328,320
Outstanding warrants to purchase common shares	0
Maximum outstanding common shares	88,215,557

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005

TO THE SHAREHOLDERS OF BIRCH MOUNTAIN RESOURCES LTD.

Management has the responsibility for preparation and fair presentation of the accompanying financial statements, including the financial processes that give rise to such consolidated financial statements. This responsibility includes selecting appropriate accounting principles and making objective judgments and estimates in accordance with Canadian generally accepted accounting principles and providing a reconciliation to generally accepted accounting principles in the United States. Management is also responsible for the preparation, fair presentation and consistency of other financial information in the Annual Financial Report that is combined with the audited consolidated financials statements.

In discharging its responsibilities for the integrity and fairness of the financial statements, management designs and maintains the necessary accounting systems and related internal controls to provide reasonable assurance that transactions are authorized, assets safeguarded and proper records maintained for reporting financial statements and other financial information in accordance with applicable generally accepted accounting principles and in accordance with applicable securities rules and regulations. Management has also established disclosure controls and procedures designed to ensure accurate and timely disclosure of material information required by regulators. Disclosure of any financial information is approved in advance by the Audit Committee.

It is the responsibility of the Audit Committee and the Board of Directors to review the financial statements in detail with management prior to their approval of the financial statements for publication. In addition, the Audit Committee meets regularly with management and the external auditor to review accounting policies, financial reporting and internal controls. The Audit Committee is comprised of three independent and financially literate directors. The Audit Committee is responsible for the compensation of the external auditor and pre-approves their retention for the appointment and any such fees related to non-audit services.

External auditors are appointed by the shareholders to audit the financial statements and report directly to them. Their report is attached to the audited consolidated financial statements that follow. The external auditors have full and free access to the Audit Committee, the Board of Directors and management.

"signed"

Douglas J. Rowe, President and Chief Executive Officer

"signed"

Hansine M. Ullberg, Vice President Finance and Chief Financial Officer

To the Shareholders of
Birch Mountain Resources Ltd.

We have audited the consolidated balance sheet of Birch Mountain Resources Ltd. as at December 31, 2005, and the consolidated statements of loss and deficit, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, these financial statements present fairly, in all material respects, the consolidated financial position of Birch Mountain Resources Ltd. as at December 31, 2005, and the results of its operations and its cash flows for the year then ended in conformity with Canadian generally accepted accounting principles.

The financial statements as at December 31, 2004 and for the years ended December 31, 2004 and 2003 were audited by other auditors who expressed an opinion without reservation on those statements in their report dated February 25, 2005 (except for notes 3 and 8, which are as of July 25, 2005).

Ernst & Young LLP

Chartered Accountants

Calgary, Canada
March 22, 2006

Canadian Dollars

As At December 31	**2005**	**2004**
Assets		
Current		
Cash and cash equivalents *(Note 3)*	**32,322,603**	5,444,270
Restricted cash *(Note 4)*	**1,000,000**	-
Accounts receivable	**476,455**	233,459
Prepaids and deposits	**441,545**	184,108
	34,240,603	**5,861,837**
Long-term asset *(Note 5)*	**232,489**	-
Property and equipment *(Note 6)*	**318,786**	181,217
Mineral properties *(Note 7)*	**13,768,974**	3,489,369
Total Assets	**48,560,852**	**9,532,423**
Liabilities		
Current		
Accounts payable and accrued liabilities	**3,369,083**	332,229
Advances on share subscriptions	**-**	173,252
Deferred revenue *(Note 8)*	**50,306**	50,306
Other current liabilities *(Note 9)*	**3,346,264**	2,500,000
	6,765,653	**3,055,787**
Asset retirement obligation *(Note 10)*	**360,000**	25,000
	7,125,653	**3,080,787**
Contingent liabilities (Note 9)		
Shareholders' equity		
Share capital *(Note 11)*	**46,950,953**	8,761,876
Contributed surplus *(Note 12)*	**1,774,873**	338,569
Deficit *(Note 13)*	**(7,290,627)**	(2,648,809)
	41,435,199	6,451,636
Total Liabilities and Shareholders' Equity	**48,560,852**	**9,532,423**

See accompanying notes to the audited consolidated financial statements.

Approved on behalf of the Board:

"signed" Director
Larry W. Shelley

"signed" Director
Kerry E. Sully

Year Ended December 31	**2005**	**2004**	**2003**
Expenses			
Amortization	**63,424**	50,336	33,632
Consulting	**96,027**	79,973	800
Mineral exploration *(Note 7)*	**540,481**	762,371	744,385
Office	**942,502**	683,316	263,247
Professional fees	**746,377**	396,552	125,175
Research	**-**	-	11,150
Salaries and benefits	**597,714**	386,579	422,135
Shareholder services and promotion	**742,439**	329,993	213,203
Stock-based compensation *(Note 15)*	**1,245,422**	246,127	66,681
Loss before the following	**4,974,386**	**2,935,247**	**1,880,408**
Interest and other income	**(332,568)**	(48,190)	(11,205)
Gain on forgiveness of debt *(Note 16)*	**-**	-	(194,000)
Gain on disposal of investment	**-**	-	(6,768)
Limestone sale *(Note 8)*	**-**	-	(100,000)
	(332,568)	(48,190)	(311,973)
Loss for year	**4,641,818**	**2,887,057**	**1,568,435**
Deficit, beginning of year	**(2,648,809)**	(27,510,684)	(25,942,249)
Elimination of deficit *(Note 13)*	**-**	27,748,932	-
Deficit, end of year	**(7,290,627)**	**(2,648,809)**	**(27,510,684)**

Loss per share			
Basic and diluted *(Note 14)*	**(0.08)**	(0.05)	(0.04)

See accompanying notes to the audited consolidated financial statements.

Birch Mountain Resources Ltd.
Consolidated Statements of Cash Flows
For the years ended December 31

	2005	2004	2003
Cash flows from operating activities			
Payments to suppliers	**(2,362,190)**	(1,321,259)	(1,491,817)
Payments to employees	**(687,429)**	(878,063)	(921,277)
Interest paid	**(4,746)**	(3,900)	(45,921)
Interest received	**325,121**	47,549	2,358
	(2,729,244)	(2,155,673)	(2,456,657)
Cash flows from financing activities			
Issuance of common shares for cash	**40,331,448**	9,381,086	4,623,601
Share issuance costs	**(2,303,853)**	(546,383)	(163,590)
Advances on share subscriptions upon the exercise of options	**(173,252)**	173,252	-
	37,854,343	9,007,955	4,460,011
Cash flows from investing activities			
Mineral exploration costs	**(7,045,773)**	(3,153,233)	(230,970)
Restricted cash	**(1,000,000)**	-	-
Purchase of capital assets	**(202,595)**	(73,071)	(29,442)
Proceeds on disposal of investment	**-**	-	26,768
Proceeds on disposal of capital assets	**1,602**	-	800
	(8,246,766)	(3,226,304)	(232,844)
Increase in cash and cash equivalents	**26,878,333**	3,625,978	1,770,510
Cash and cash equivalents, beginning of year	**5,444,270**	1,818,292	47,782
Cash and cash equivalents, end of year	**32,322,603**	**5,444,270**	**1,818,292**

See accompanying notes to the audited consolidated financial statements.

1. Nature of operations

Birch Mountain Resources Ltd. (the "Company"), incorporated under the jurisdiction of the Business Corporations Act of Alberta, is exploring and preparing to develop its mineral leases and permits in Northern Alberta. At inception, the efforts of the Company were focused on exploration of precious metals and research into precious metals technology. However, over the past three and a half years its focus has been on the development of its industrial minerals. The Company has two projects in its industrial minerals division, the Muskeg Valley Quarry and the Hammerstone Project, both of which are development of the limestone contained on the Company's mineral leases. The Hammerstone Project is a planned quarry expansion and quicklime and cement plants. The Muskeg Valley Quarry has been approved for development by the governmental regulators. The rights of the Company are to develop, extract and sell limestone products. The Company must comply with conditions of the regulatory approvals such as to monitor ground water, report extraction and pay royalties thereon and the reclaim the site at the end of production. To date, the Company has not earned significant revenues and is considered to be in the development stage. The recoverability of the amounts shown for mineral properties is dependant upon the existence of economically recoverable reserves, securing and maintaining title and beneficial interest in the properties, and the ability of the Company to obtain the necessary financing or cash flow to continue the development of its mineral properties. On February 25, 2005, the Company released an independent technical report, which indicates the potential for a limestone quarry in the Fort McMurray area and reports an estimated value for the mineral reserves in excess of the current carrying value of the mineral properties.

2. Significant accounting policies

(a) *Basis of presentation*

These consolidated financial statements are prepared in accordance with generally accepted accounting principles in Canada. The principal accounting policies followed by the Company, which have been consistently applied in the preparation of these consolidated financial statements, are summarized below. A summary of the difference between accounting principles generally accepted in Canada and those generally accepted in the United States is contained in note 22 to these consolidated financial statements.

(b) *Principles of consolidation*

The consolidated financial statements are expressed in Canadian dollars and are prepared in accordance with Canadian generally accepted accounting principles. These financial statements include the accounts of the Company and its wholly owned subsidiaries, Dawson Bay Minerals Inc., and Rockyview Development Limited and its subsidiaries, which have been inactive for some time. All intercompany balances and transactions have been eliminated.

(c) *Use of estimates*

The preparation of the consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent liabilities as at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those reported. Significant areas requiring the use of management estimates include estimates related to the determination of impairment of mineral exploration costs, reclamation obligations and determination of qualifying renouncements and the assumptions used in calculating stock option compensation expense. These estimates are reviewed periodically and, as adjustments become necessary, they are reported in earnings in the periods in which they become known.

(d) *Cash and cash equivalents*

Cash and cash equivalents include balances with Canadian chartered banks and investment certificates with maturities of three months or less at the date of purchase.

(e) *Property and equipment*

Property and equipment are recorded at cost. Amortization is provided over their estimated useful lives, using the following methods and rates:

	Method	Annual Rate
Equipment	Declining balance	20% - 30%
Computer	Declining balance	30% - 100%
Leasehold improvements	Straight line	5 years

2. Significant accounting policies (continued)

(f) Mineral properties

The Company expenses mineral exploration costs in the year they are incurred, unless on a property-by-property basis the deferral criteria are met and it is probable that they will be recoverable from the future operations of the related project. When it is determined that a mining property can be economically developed as a result of established proven and probable reserves, the costs of further exploration and development to further delineate the reserve on such a property are capitalized. Determination as to the establishment of proven and probable reserves is based on results of technical reports, which indicate whether a property is economically feasible. These expenditures will be depleted on a unit of production basis when the properties are developed to the stage of commercial production. During 2003, the Company began capitalizing expenditures related to the exploration and testing of a limestone property, as the criteria for capitalization had been met.

The Company reviews its capitalized costs on a mineral property under development on an annual basis, or more frequently if events warrant, and will recognize an impairment in value on each property to the extent that the recoverable amount based on estimated future cash flows on a discounted basis is less than the carrying amount of the property. Future cash flows are estimated based on future recoverable minerals based on proven and probable reserves. Future cash flow estimates will also incorporate expected sales prices for recoverable minerals, costs of production and taxes, capital expenditures and development costs, remediation and closure costs, utilizing assumptions from its feasibility studies and subsequent engineering, geological or financial information where operations have not yet commenced.

Management's estimates of mineral prices, recoverable proven and probable reserves and operating and capital costs are subject to certain risks and uncertainties, which may affect the recoverability of mineral property costs. Although management has made its best estimate of these factors, it is possible that changes could occur in the near term, which could adversely affect the future net cash flows to be generated from the properties or the financial position of the Company.

(g) Asset retirement obligation

The Company has adopted the new recommendations of the CICA relating to accounting for asset retirement obligations. This recommendation replaces the previous method of accounting for site restoration costs on an accrual basis. The Company has adopted the new standard on a retroactive basis in accordance with the CICA recommendations on Accounting Changes. Under the new standard, a liability for the fair value of environmental and site restoration obligations are recorded when the obligations are incurred and the fair value can be reasonably estimated. The fair value of the obligations is based on the estimated cash flow required to settle the obligations discounted using the Government of Canada Bond Rate for the applicable term adjusted for the Company's credit rating. The fair value of the obligation is recorded as a liability with the same amount recorded as an increase in capitalized costs. The amounts included in capitalized costs are depleted using the unit-of-production method. The liability is adjusted for accretion expense representing the increase in the fair value of the obligations due to the passage of time. The accretion expense is recorded as an operating expense. There is no impact on the current year's financial statements, as production has not yet occurred.

(h) Flow-through shares

Under Canadian income tax legislation, corporations are permitted to issue shares whereby the Company agrees to incur qualifying expenditures, as defined under the Canadian Income Tax Act, and renounce the related income tax deductions to the investors. The tax benefits renounced are reflected as a future tax liability and deducted from the proceeds of share capital.

(i) Research costs

The Company was actively engaged in researching new mineral technology applications. Costs associated with such projects, including patent application costs, are expensed in the period they are incurred.

2. Significant accounting policies (continued)

(j) Future income taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are recorded based on temporary differences between the carrying amount of balance sheet items and their corresponding tax bases. In addition, the future benefits of income tax assets, including unused tax losses, are recognized, subject to a valuation allowance, to the extent that it is more likely than not that such future benefits will ultimately be realized. Future income tax assets and liabilities are measured using substantively enacted tax rates and laws expected to apply when the tax liabilities or assets are to be either settled or realized.

(k) Stock-based compensation and contributed surplus

The Company has a stock-based compensation plan as described in note 11. Effective January 1, 2003, the Company adopted the new accounting standards of the Canadian Institute of Chartered Accountants for accounting for stock-based compensation.

The Company has adopted the fair value method of accounting for all stock options granted whereby stock-based compensation on options granted is charged as an expense or capitalized depending on the nature of the grant, in the period the options are vest, based on the estimated fair value at the date of grant using the Black-Scholes Option Pricing Model. Prior to January 1, 2003, the Company only expensed the fair value of options granted to non-employees and disclosed those granted to all others on a pro-forma basis only. Consideration paid by the option holders to the Company upon exercise of options is credited to common share capital.

(l) Loss per share amounts

Loss per share amounts are computed using the weighted-average number of common shares outstanding during the year. Diluted loss per share is calculated based on the treasury stock method, which assumes that any proceeds obtained on the exercise of options and warrants would be used to purchase common shares at the average trading price for the period.

(m) Foreign currency translation

Foreign currency denominated assets and liabilities are translated at the exchange rate prevailing at the balance sheet date for monetary items. Non-monetary assets and liabilities are translated at the rates prevailing at the transaction date. Revenues and expenses are converted at average exchange rates for the period. Any exchange gain or loss that arises on translation is included in the consolidated statement of loss for the period.

3. Cash and cash equivalents

At December 31, 2005, cash equivalents included $31,911,272 (2004 - $4,425,596) invested in guarantee investment certificates earning interest at rates of 2.15% to 2.55% (2004 – 2.4%).

4. Restricted cash

The Company pledged as collateral $1,000,000 against a demand operating line, through assignment of one-year term deposits to the Royal Bank of Canada. The Company has not drawn on the operating line except for a stand-by letter of credit, which is explained in Note 10.

5. Long-term asset

The Company made a payment for the estimated timber damage charges for the clearing of the currently approved limestone quarry. The trees will be cleared as the limestone is accessed over a number of years of planned production. This long-term asset will be reduced as the clearing occurs on a basis of hectares cleared over the total amount of hectares for which the timber damage payment was based, being the total approved area.

6. Property and equipment

	2005			2004		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Equipment	**459,429**	**229,843**	**229,586**	312,522	205,485	107,037
Computer	**333,238**	**251,222**	**82,016**	279,553	220,233	59,320
Leasehold improvements	**38,382**	**31,198**	**7,184**	38,382	23,522	14,860
	831,049	**512,263**	**318,786**	630,457	449,240	181,217

7. Mineral properties

The Company holds a significant number of permits, applications to convert permits to leases and leases on mineral rights in the Athabasca region of Northern Alberta.

Athabasca Region

At December 31, 2005, the Company's mineral property in the Athabasca region consisted of 32 (2004 – 38) permits, which includes 22 (2004 – 15) permits in the process of being converted by the Company to leases and 69 (2004 – 65) leases for a total area of 402,748 (2004 – 335,190) hectares.

The Company has capitalized expenditures related to its industrial mineral projects and expensed amounts related to its mineral exploration and technology division. Amounts capitalized and expensed related to mineral properties are as follows:

Mineral properties capitalized

	At Dec 31, 2005	For the year ended Dec 31, 2005	At Dec 31, 2004	For the year ended Dec 31, 2004	At Dec 31, 2003
Asset retirement obligation	**360,000**	335,000	25,000	25,000	-
Administration	**811,137**	731,754	79,383	73,910	5,473
Assay and geological	**105,744**	28,004	77,740	77,740	-
Land lease and permit	**59,808**	9,278	50,530	47,320	3,210
Materials, services and drilling	**5,084,304**	2,563,638	2,520,667	2,308,342	212,325
Site preparation	**6,001,827**	5,941,256	60,570	60,571	-
Salaries	**1,063,010**	478,755	584,255	479,089	105,166
Travel and accommodations	**283,144**	191,920	91,224	81,262	9,962
	13,768,974	**10,279,606**	**3,489,369**	**3,153,233**	**336,136**

Mineral exploration costs

	2005	2004	2003
Administration	**36,209**	34,276	65,797
Assay and geological	**84**	654	20,429
Land lease and permit	**390,088**	611,857	146,327
Materials, services and drilling	**18,130**	45,737	179,060
Salaries	**89,715**	66,708	315,925
Travel and accommodations	**6,255**	3,139	16,847
	540,481	**762,371**	**744,385**

Since inception, the Company has spent a total of $17,734,046 on mineral exploration and development of which, $13,768,974 has been capitalized.

8. Deferred revenue

In September 2003, the Company signed an agreement to sell limestone to Syncrude Canada Ltd. within Syncrude's Aurora mine, which would be extracted by Syncrude and reported monthly. The Company received a non-refundable $100,000 payment and a payment of $57,188 to be applied against future extraction. During the current year, no limestone was extracted (2004 – nil; 2003 - $6,882)

9. Other current liabilities

The Company raised capital through the issuance of flow through shares in 2003 and 2004, that provided for an indemnity to the subscriber for additional taxes payable if Birch was unable to or failed to renounce the qualifying expenditures as agreed, without limiting the recourse of the subscriber. The Company applied for and filed the necessary forms to qualify for and renounce expenditures in 2002, 2003 and 2004 and has subsequently determined some of these expenditures do not qualify for flow through tax treatment. The Company is exposed to costs for the indemnification of the subscribers and any assessed corporate taxes, penalties and interest. The Company has estimated and accrued a potential liability in the amount of $3,346,264 (2004 - $2,500,000). Subsequent to December 31, 2005, the Company amended its tax filings and the related reported tax balances have been revised to reflect this change. Based on information available at the time of these amended filings, the Company increased its original estimate of the potential liability by $300,000. This change has been accounted for as a change in estimate due to better information becoming available. The offsetting entry is recorded to share capital as the amount is attributable to flow through share capital issued in prior years. This amount is subject to measurement uncertainty due to the tax filing positions of the subscribers, their tax rates and the amount of corporate taxes, penalties or interest that may be payable, which will not be known until any potentially affected subscribers as reassessed for their tax positions by the Canada Revenue Agency and these amounts become known to the Company. The Company believes this estimate could vary higher or lower by up to fifteen percent.

10. Asset retirement obligation

The Company has estimated the total discounted cost of reclaiming the site of its limestone quarry, which underwent significant development and site work during the year to be $360,000 (undiscounted - $1,100,000). This estimate is based on costs provided by consulting engineers to the Company for costs that would be incurred by third parties to return the Muskeg Valley Quarry to its reclaimed status as defined under the Company's environmental and operating permits. The estimate has been determined using a 2% inflation rate and a 7.5% discount factor for costs allocated to two categories. Site infrastructure will service the quarry for its estimated fifty year life and the initial production quarry area is estimated not be reclaimed for ten years. This amount is subject to measurement uncertainty with respect to costs in the local market for third parties to perform this work, the actual timing of reclamation and the discount rate used. A $670,000 irrevocable standby letter of credit was drawn on the Company's operating line of credit as a guarantee to Alberta Environment for the estimated future reclamation.

11. Share capital

(a) Authorized capital

Unlimited number of common voting shares, no par value
Unlimited number of preferred shares, issuable in series
Unlimited number of non-voting shares

(b) Issued - Common shares

	Number	Amount
Balance December 31, 2003	50,449,085	28,946,174
Issued for cash		
Issued on exercise of options	545,180	198,834
Issued on exercise of warrants	5,395,292	2,723,054
Private placements (ii)	3,891,013	2,865,038
Flow-through shares (ii)	6,026,229	2,294,344
Reclassified from contributed surplus upon exercise of options	-	29,746
Share issuance costs	-	(546,382)
Elimination of deficit (note 13)		(27,748,932)
Balance December 31, 2004	66,306,799	8,761,876
Issued for cash		
Public offering (i)	9,000,000	36,000,000
Issued on exercise of options	2,229,500	1,430,848
Issued on exercise of warrants	2,885,188	2,900,600
Reclassified from contributed surplus upon exercise of options	-	461,482
Share issuance costs (i)	-	(2,303,853)
Reduction in share capital for flow through shares (note 10)		(300,000)
Balance December 31, 2005	**80,421,487**	**46,950,953**

(i) On September 2, 2005, the Company closed a public equity offering of 9,000,000 shares at $4.00 per share for gross proceeds of $36,000,000. Share issue costs of $2,303,853 were incurred in connection with this offering. These fees are reflected as a reduction in the proceeds from the share issuance.

(ii) In December 2004, the Company completed a private placement of 732,263 units at $1.50 per unit. Of these units 142,896 units were flow-through and the remaining 589,367 consisted of one common share and one common share warrant, entitling the holder to purchase one additional common share at a price of $2.00 before December 31, 2005.

In July, August and December 2004, the Company completed a private placement in three tranches. A total of 9,184,979 units at $0.60 per unit were issued. Of these units 5,883,333 units were flow-through and the remaining 3,301,646 consisted of one common share and one-half of one common share warrant, each whole share warrant entitling the purchase of one common share at a price of $0.75 before December 31, 2005. The agent received 666,667 warrants, each warrant entitling the purchase of one common share at a price of $0.75 before December 31, 2005.

11. Share capital (continued)

(c) *Options*

The Company has a stock option plan that was established in 1994 and has been subsequently amended by the shareholders, including most recently in 2004. The purpose of the plan is to offer persons who provided services to the Company, whether directors, officers, consultants or employees, an opportunity to obtain an interest in the Company through the purchase of common shares and to aid in attracting, retaining and encouraging the continued involvement of such persons. The plan contains provisions stating that the option period may not exceed five years and that the number of common shares issuable on exercise of outstanding stock options may not exceed 10,269,047 shares. The plan is administered by the Compensation Committee of the Board of Directors who determines to whom options shall be granted including the terms, and vesting of the grants. When options are granted, the Compensation Committee sets the strike price equal to the closing price on the Toronto Venture Stock Exchange of the previous day.

The Company has outstanding options on common shares as follows:

	Number of Options	Exercise Price Range ($)	Weighted Average Exercise Price ($)	Expiry Date
December 31, 2003	6,391,250	0.22 – 1.36	0.51	2004 – 2008
Granted	2,135,000	0.50 – 0.74	0.55	2009
Cancelled	665,000	1.36	1.36	2004
Exercised	545,180	0.26 – 0.55	0.40	2007-2008
December 31, 2004	7,316,070	0.26 – 0.74	0.37	2005-2009
Granted	2,465,000	2.09 – 7.81	2.60	2009
Cancelled	350,000	2.35 – 2.48	2.41	2009
Exercised	2,229,500	0.26 – 2.48	0.78	2007-2010
December 31, 2005	**7,201,570**	**0.26 – 7.81**	**0.84**	**2006 -2010**

Stock options outstanding and exercisable as at December 31, 2005 are as follows:

Exercise Price ($)	Number of Options Outstanding	Number of Options Exercisable	Expiry Date
0.60	65,000	65,000	January 2006
0.65	125,000	125,000	April 2006
0.50	67,000	67,000	May 2006
0.26	790,000	790,000	March 2007
0.34	975,000	975,000	April 2007
0.30	1,550,000	1,550,000	October 2008
0.53	125,000	125,000	May 2009
0.55	1,649,500	1,237,125	August 2009
0.74	7,500	5,625	November 2009
2.35	267,500	133,750	January 2010
2.48	1,092,570	546,285	March 2010
2.09	262,500	131,250	April 2010
7.81	225,000	56,250	November 2010
0.84	**7,201,570**	**5,807,825**	**2006 - 2010**

(d) Warrants

In relation to private placements, the Company has issued warrants. There are no shares held in escrow or reserved for issuance in relation to warrants. Warrants outstanding at December 31, 2005 are as follows:

	Number of Warrants	Exercise Price Range ($)	Weighted Average Exercise Price ($)	Expiry Date
December 31, 2003, outstanding	10,792,381	0.50	0.50	2004
Issued	2,906,857	0.75 – 2.00	1.01	2005
Expired	5,418,758	0.50	0.50	2004
Exercised (ii)	5,395,292	0.50 – 2.00	0.50	2004
December 31, 2004, outstanding	2,885,188	0.75 – 2.00	1.01	2005
Exercised (i)	2,885,188	0.75 – 2.00	1.01	2005
December 31, 2005, outstanding	-	-	-	-

(i) During 2005, all outstanding warrants were exercised before their expiry at December 31, 2005. A corresponding number of common shares were issued at a weighed price of $1.01 for total consideration of $2,900,600.

(ii) During 2004, 5,395,292 warrants were exercised and a corresponding number of common shares were issued at a weighted average price of $0.50 each for a total consideration of $2,723,054.

12. Contributed surplus

Balance, December 31, 2003	89,957
Options granted to employees, directors and officers	246,127
Options granted to advisors	32,231
Options exercised and reclassed to share capital	(29,746)
Balance December 31, 2004	338,569
Options granted to employees, directors and officers	1,700,671
Options granted to advisors	197,114
Options exercised and reclassed to share capital	(461,482)
Balance December 31, 2005	**1,774,873**

13. Deficit

Pursuant to Section 38 of the Business Corporations Act of Alberta, the shareholders approved a reduction in the stated capital by the amount of the accumulated deficit as of June 30, 2004. As a result, the deficit and share capital were reduced by $27,748,932.

14. Loss per share amounts

Basic loss per share is calculated using the weighted-average number of shares outstanding for the year. For purposes of the calculations, the weighted-average number of shares outstanding was 71,644,531 (2004 – 56,596,951; 2003 – 41,147,226,). Diluted loss per share amounts have not been calculated as the effect of common shares issuable upon exercise of share options and warrants is anti-dilutive. All of the Company's outstanding options are available for dilution in future periods.

15. Stock-based compensation and stock-based expenses

Stock-based compensation expense and stock-based expenses recorded were are follows:

	2005	2004	2003
Stock-based compensation for stock issued and vested in the current period (i)	**798,569**	112,765	66,681
Stock-based compensation for stock issued in prior periods and vested in the current period	**902,102**	133,362	-
Less stock-based compensation capitalized in mineral properties	**(455,248)**	-	-
Net stock-based compensation expense	**1,245,422**	**246,127**	**66,681**
Stock-based expenses for options issued to advisors included in professional fees in the period (ii)	197,114	35,922	-
Total stock-based expenses	**1,442,536**	**282,049**	**66,681**

(i) During 2005, $350,000 stock options at a weighted average price of $2.41 were forfeited by a director.

(ii) Expenses included in professional fees were valued based on the market price of the stock at the time of the transaction.

The Company uses the Black-Scholes option-pricing model to provide a fair-value for stock based compensation for employees, directors, officers and advisors. The weighted average assumptions used for options issued to employees, directors and officers may differ from those used for options issued to advisors as the expected life of the options issued by the Company may be different as the term of the option is often shorter.. The fair value of each option was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	2005		2004		2003	
	Employees, directors and officers	**Advisors**	**Employees, directors and officers**	**Advisors**	**Employees, directors and officers**	**Advisors**
Expected life	**2 years**	**2 years**	1 to 2 years	1 year	3 years	2 year
Risk-free interest rate	**4.3 to 4.8%**	**4.3 to 4.8%**	3.8%	3.8%	3.9%	3.8%
Expected volatility	**85% - 100%**	**85% - 100%**	65%	65%	65%	65%
Annual dividends	**nil**	**nil**	nil	nil	nil	nil

Prior to January 1, 2003, the Company was not required to recognize compensation expense for options granted to employees, directors, officers and advisors. Had the fair-value method been used from January 1, 2001 to January 1, 2003, the Company's net loss and net loss per share, adjusted for the amortization of stock options issued in prior periods into stock based expenses, would have been as follows:

	2005	2004	2003
Pro-forma loss	**(4,714,830)**	(2,960,069)	(1,641,447)
Loss per share, basic	**(0.07)**	(0.05)	(0.04)

16. Gain on forgiveness of debt

During 2003, the Company reversed a $194,000 accrued payable that was an estimate accrued in 1998 and no longer payable relating to the estimated costs of discontinuing the Indonesian operations.

17. Commitments

The Company has land lease agreements on exploration properties and rents premises and equipment under operating leases. Commitments under these agreements require the following payments over the next five years:

	Land	Other	Total
2006	471,172	265,563	**736,735**
2007	471,172	93,048	**564,220**
2008	471,172	29,620	**500,792**
2009	471,172	-	**471,172**
2010	471,172	-	**471,172**
	2,355,860	**388,231**	**2,744,091**

Not included in the above amounts is a contingent royalty commitment on one land lease to pay $.015 per tonne of limestone sold, should limestone be produced from minerals on that specific lease.

18. Related-party transactions

The Company incurs transactions with related parties, in the normal course of business. The transactions are measured at the exchange amount, which is the consideration established and agreed to by the related party and were as follows:

- Included in shareholder services and promotion is $7,874 (2004 - $14,656; 2003 - $1,469) paid to a company controlled by the spouse of a director.
- Included in professional fees is $85,734 (2004 - $37,159; 2003 – $26,327) of consulting and legal fees paid to companies owned by an officer. The Company has a contractual retainer agreement for $4,000 per month.
- Included in professional fees is $240,859 (2004 - $99,145; 2003 – $77,254) of legal fees paid to a law firm in which an officer was a partner.
- Included in accounts payable is $18,789 (2004 - $7,945; 2003 - $24,953) relating to these transactions.

19. Income taxes

The income tax recovery differs from the amount that is expected by applying the current tax rates for the following reasons:

	2005	2004	2003
Loss before taxes	4,641,818	2,887,057	1,568,435
Expected tax recovery at (2005–33.62%; 2004 –36.70%; 2003–40.80%)	1,560,579	1,059,550	639,921
Non-deductible expenses for tax	(593,026)	(120,779)	(36,613)
Other	179,941	(9,665)	-
Change in enacted tax rates	(602,277)	-	-
Valuation allowance	(545,217)	(929,106)	(608,308)
Future income tax recovery	-	-	-

The realization of income tax benefits related to these future potential tax deductions is uncertain and cannot be viewed as more likely than not. Accordingly, no future income tax asset has been recognized for accounting purposes.

19. Income taxes (continued)

Future income tax assets consist of the following temporary differences:

	2005	2004	2003
Industrial mineral mines (i)	**4,974,118**	6,590,913	5,840,161
Property and equipment (i)	**-**	69,911	90,770
Scientific Research and Experimental Development expenditures unclaimed (ii)	**85,141**	77,702	79,438
Non-capital loss carry forwards (iii)	**2,815,375**	654,525	436,552
Share issuance costs and other	**754,824**	154,518	54,692
Asset retirement obligation	**121,032**	-	-
Valuation allowance	**(8,750,490)**	(7,547,569)	(6,501,613)
Future tax assets (net of valuation allowance)	**-**	-	-

(i) The Company has undepreciated capital cost allowance of $28,880,000 (2004 - $21,480,000; 2003 - $16,804,000), which may be carried forward indefinitely.

(ii) The Company has Scientific Research and Experimental Development costs of $211,000, which may be carried forward indefinitely.

(iii) Non-capital loss carry forwards of approximately $8,400,000 are available to offset future income. If unused, they will expire as follows:

2006	$ 185,000
2007	-
2008	719,000
2009	20,000
2010	-
2011	4,116,000
2012	3,360,000

20. Segmented information

The Company's principal business segment, Industrial Minerals, is the acquisition, exploration and development of its mineral leases and permits. The Company also engages in ongoing exploration and research of mineral technology. In identifying these segments the Company considers the organizational structural and areas of budget responsibility as well as the general corporate philosophy. The Industrial Minerals division will generate its revenue from the sale of limestone products such as aggregates and reagent products. The Mineral Exploration and Technology division could generate income from the sale of technology patents or significant valuable mineral or metals discoveries. In 2003 and 2004 the Mineral Exploration and Technology segments of the business were reported separately. As they have become less significant segments and the general corporate philosophy has shifted to industrial minerals, these segments have been combined and the prior period amounts reclassified to reflect the combination into one segment. The accounting for revenue, expense and assets attributed to each segment is based on each transaction, which is coded to separate general ledger department codes for each segment. The Company's activities are focused in Western Canada and the Company's assets are located in Alberta.

	Industrial Minerals	Mineral Exploration and Technology	Corporate	Total
2005				
Revenue	-	-	332,568	332,568
Expense	-	540,481	4,433,905	4,974,386
Loss	-	(540,481)	(4,101,337)	(4,641,818)
Assets	14,424,221	33,798	34,102,833	48,560,852
2004				
Revenue	-	-	48,190	48,190
Expense	-	762,371	2,172,876	2,935,247
Loss	-	(762,371)	(2,124,686)	(2,887,057)
Assets	3,585,938	59,393	5,887,092	9,532,423
2003				
Revenue	100,000	-	211,973	311,973
Expense	471,191	273,194	1,136,023	1,880,408
Loss	(371,191)	(273,194)	(924,050)	(1,568,435)
Assets	364,892	39,510	2,019,831	2,424,233

21. Financial instruments

Fair values
The carrying amount of cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities and other current liabilities approximates their fair value because of the short-term maturities of these items.

Foreign currency risk
The Company maintains cash balances and occasionally enters into transactions to purchase goods and services denominated in United States currency for which the related expenses and accounts payable balances are subject to exchange rate fluctuations. The transactions and balances have been stated in Canadian dollars in accordance with the Company's foreign currency translation policy (Note 2). As at year-end, the following items were denominated in United States currency and have been converted into Canadian currency at the year-end exchange rate.

	2005	2004
Cash (CAD$)	**234,711**	387,182
Accounts payable (CAD$)	**47,142**	20,376

22. Material differences between Canadian and United States generally accepted accounting principles

The consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principals in Canada ("Canadian GAAP"), which in most respects conform to accounting principles generally accepted in the United States ("U.S. GAAP").

If these consolidated financial statements were prepared in accordance with U.S. GAAP, the impact would be as follows:

	2005	2004
Mineral properties – Canadian GAAP	**13,768,974**	3,489,369
Exploration expenditures capitalized (a)	**(1,525,699)**	(1,525,699)
Mineral properties - U.S. GAAP	**12,243,275**	**1,963,670**
Shareholders' equity – Canadian GAAP	**41,435,199**	6,451,636
Exploration expenditures capitalized (a)	**(1,525,699)**	(1,525,699)
Shareholders' equity - U.S. GAAP	**39,909,500**	**4,925,937**

The impact on the consolidated statement of loss would be as follows:

	2005	2004	2003
Loss for the year - Canadian GAAP	**4,641,818**	2,887,057	1,568,435
Exploration expenditures capitalized (a)	-	1,189,563	336,136
Loss for the year - U.S. GAAP	**4,641,818**	**4,076,620**	**1,904,571**
Loss per share - U.S. GAAP			
Basic and fully diluted	**(0.08)**	(0.07)	(0.05)

Significant differences between Canadian GAAP and U.S. GAAP that would have an effect on these consolidated financial statements are as follows:

(a) Mineral properties are accounted for in accordance with Canadian GAAP as discussed in Note 2. For U.S. GAAP purposes, exploration costs relating to unproven mineral leases and permits as well as acquisition costs for leases and permits that do not provide for unrestricted exploration, are expensed as incurred. The Company tracks expenditures on its mineral properties as exploration or development and under U.S. GAAP capitalizes costs relating to the development of proven reserves. Capitalized exploration costs are then assessed to determine if a writedown in the carrying value is necessary and any writedown would be considered an operating expense and included in the determination of operating loss for the period in which the writedown occurred.

Prior to January 1, 2003, the Company's treatment of mineral exploration costs as an expense is similar to the treatment under U.S. GAAP, resulting in no difference. For 2003, all $336,136 of expenditures capitalized under Canadian GAAP would be expensed as operating costs under U.S. GAAP, increasing the loss for 2003. For 2004, U.S. GAAP would allow for the capitalization of development costs including land costs, pit planning, road design and costs of obtaining government approvals for expenditures related to proven mineral reserves, which were reported in an independent technical report. The expenditures that related to unproven reserves totalling $1,189,563, would be expensed under U.S. GAAP, increasing the loss for 2004. After January 1, 2005, all expenditures capitalized under Canadian GAAP related to proven reserves and hence are also capitalized under US GAAP.

(b) Commencing January 1, 2003, the Company adopted the fair value method of accounting for stock options for both Canadian and U.S. GAAP purposes. The effect of this change was that stock-based compensation is recorded as an expense instead of disclosing the effect of granting options as pro-forma information in the notes to the financial statements.

22. Material differences between Canadian and United States generally accepted accounting principles (continued)

For the years ended December 31, 2004 and 2003, these costs were calculated in accordance with the Black-Scholes option-pricing model assuming no dividends are paid, an annual risk-free interest rate of 3.8% to 3.9%, an expected volatility of 65% and an expected life of one to three years. For 2004, the fair value of the options, calculated as $278,357 (2003 - $66,681), is included in the net loss. Prior to Jan 1, 2003, the Company accounted for stock options in accordance with APB Opinion No.25, *Accounting for Stock Issued to Employees* (APB 25). Under APB 25, stock-based compensation to employees and directors is calculated using the intrinsic-value method whereby compensation cost is recorded for the excess, if any, of the quoted market price versus the exercise price at the date granted.

Had the Company adopted the fair value method for its U.S. GAAP disclosure prior to Jan 1, 2003, the following net losses would have been reported.

	2005	2004	2003
Loss for the year - U.S. GAAP	**4,641,818**	4,076,620	1,904,571
Pro-forma stock compensation	**73,012**	73,012	73,012
Pro-forma loss for the year - U.S. GAAP	**4,714,830**	4,149,632	1,977,583
Pro-forma loss per share - U.S. GAAP			
Basic and diluted	**(0.08)**	(0.07)	(0.05)

(c) Canadian GAAP allows for the reduction of stated capital of outstanding common shares with a corresponding offset to deficit. This reclassification, made by the Company in 2004, is not permitted by U.S. GAAP. As a result, under U.S. GAAP, capital stock and deficit is increased by $27,748,932 in 2005 and 2004.

(d) For U.S. GAAP cash flow statement purposes, mineral exploration costs would be shown under operating activities rather than under investing activities.

New Accounting Pronouncements in U.S. GAAP

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement 123R, Share-Based Payments. This statement revised Statement 123, Accounting for Stock-Based Compensation, and supersedes APB Opinion 25, Accounting for Stock Issued to Employees. Statement 123R requires all stock-based awards issued to employees to be measured at fair value and to be expensed in the income statement. This statement is effective for fiscal years beginning after June 15, 2005. We are currently expensing all stock based awards issued to employees, directors and advisors using the fair value method and do not believe the adoption of this standard will impact our results of operations or financial position.

In March 2005, the Emerging Issues Task Force ("EITF") reached a consensus on Issue No. 04-6 Accounting for Stripping Costs Incurred during Production in the Mining Industry. The EITF concluded that the costs of removing overburden and waste materials, referred to as "stripping costs" incurred during the production phase of a mine are variable production costs and should be included in the costs of the inventory produced during the period that the stripping occured. Issue No. 04-6 is effective for the first reporting period in fiscal years beginning after December 15, 2005. As the Company begins production subsequent to December 31, 2005, we will follow the recommendations of No. 04-6.

In June 2005, The FASB issued Statement 154, Accounting Changes and Error Corrections, which replaces APB Opinion 20 and FASB Statement 3. Statement 154 changes the requirement for the accounting and reporting for a change in accounting principle. Opinion 20 previously required that most voluntary changes in accounting principles be recognized by including the cumulative effect of the new accounting principle in net income of the period of the change. In the absence of explicit transition provision provided in a new or existing accounting pronouncement, Statement 154 now requires retrospective application of changes in accounting principles to prior period financial statements, unless it is impracticable to do so. This Statement is effective for fiscal years beginning after December 15, 2005. We do not expect the adoption of this statement will have a material impact on our results of operations or financial position.

23. Subsequent events

Subsequent to year-end, an additional 592,500 stock options were issued to employees, directors and officers.

24. Comparative figures

Certain comparative figures have been reclassified to confirm with presentation adopted in the current year.

CORPORATE INFORMATION

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Suite 300, 250 Sixth Avenue SW Calgary, Alberta, T2P 3H7 Phone: 403-262-1838 Fax: 403-263-9888	Hammerstone Products Ltd. Sales Phone: 403-262-1838 Muskeg Valley Quarry Fort McKay, Alberta Quarry Phone: 780-713-8262	www.birchmountain.com jquinn@birchmountian.com
Management	**Board of Directors**	**Shareholder Information**
Douglas Rowe President and CEO Don Dabbs Senior Vice President Derrick Kershaw Senior Vice President Hugh Abercrombie VP, Exploration Russ Gerrish VP, Engineering and Operations David Reid VP, Facilities Engineering Hansine Ullberg VP Finance and CFO	Kerry Sully, Chairman (1) Charles Hopper (1,2) Jack Clark (3,4) Larry Shelley (1,2) Lanny McDonald (2,3) Doug Rowe Don Dabbs (4) Derrick Kershaw (3,4) Committee Members (1) Audit (2) Governance and Risk (3) Compensation (4) Health, Safety and Environment	Exchange Listing TSXV: BMD AMEX: BMD Legal Counsel Borden Ladner Gervais, LLP Hodgson Russ, LLP Auditor Ernst and Young, LLP Bankers Royal Bank of Canada Registrar and Transfer Agent Computershare Trust Company of Canada